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Welcome to Russia

Your visit to Moscow comes at a time of real disconnect in the U.S.-Russian relationship. Disagreements over European security, Russia's role in its neighborhood, and the Kremlin's creeping authoritarianism were followed by the rupture over Russia's decision to send forces into Georgia and to recognize the breakaway

regions of South Ossetia and Abkhazia. Having tapped into substantial public disapproval of U.S. policies on Iraq, Kosovo, NATO enlargement, missile defense, and Georgia, President Medvedev and Prime Minister Putin enjoy broad popular support for Russia's more assertive foreign policy. In his November 5 address to the nation, Medvedev sent an ill-tempered message to President-elect Obama, reprising a litany of complaints against the U.S. and threatening to deploy short-range nuclear missiles to Kaliningrad if the U.S. proceeds with missile defense plans. While both Medvedev and Putin have left the door open to closer cooperation with the new U.S. administration, Russians believe the onus is on the U.S. to set a new tone and to "return to realism." Never easy

interlocutors, your Russian counterparts will push for a new U.S. approach to outstanding disputes.

The Political Tandem

More than six months after Medvedev's inauguration, questions remain about Russia's political succession. As Prime Minister, Putin continues to play a dominant role, bestowing legitimacy on Medvedev and heading the ruling party, which enjoys a constitutional majority in the Duma. Putin used a December 4 national press conference to dismiss rumors of early elections, but declined to speculate about his possible return to the Kremlin in 2012. While Medvedev has focused on foreign policy, Putin has taken full responsibility for guiding Russia through the economic crisis. It is an open question

whether the political passivity that marked Russia's last eight years of constantly expanding wealth and economic growth will erode as Russians confront the reality of rock-bottom energy prices, plummeting foreign direct investment, and increasing unemployment. At present,

both leaders enjoy high popularity, with 59% of Russians expressing trust in Putin and 44% in Medvedev.

While Medvedev campaigned on an agenda of economic and political modernization, Russia's democratic development remains stalled, with no institutional check on a powerful elite concentrated in the White House and Kremlin. Civil society and human rights activists are under pressure to scale back their interaction with foreign donors and to restrict or curtail activity that

questions the legitimacy or the decision-making authority of leaders. "Opposition" political parties are loyal to the Kremlin, and the "real" opposition is both scarce and consumed by in-fighting.

National television is state-owned and provides a diet of pro-government reports. While small-circulation newspapers and magazines provide critical coverage and the Internet remains unfettered, journalists throughout the country have been threatened, beaten and sometimes killed for exposing corruption. The Russian Orthodox Church, which is in the process of naming a new leader following the death of Patriarch Aleksey II, remains the dominant religious entity in the country, enjoying close ties and support from the government. The revival of religious association since the collapse of the Soviet Union has been striking, with 71 percent of Russians identifying themselves as Orthodox.

#### The Georgia Rupture

While concerns over the economy have pushed Georgia into the background for the average Russian, the August conflict left an indelible imprint. Russians rallied behind the government's decision to go to war against Georgia, outraged by the killing of Russian peacekeepers and South Ossetian civilians, as well as by the absence of international condemnation of Georgian actions.

Saakashvili remains vilified as a war criminal, and few are persuaded that the U.S. did not provide a "green light." In provoking Georgia's attack, Russia secured its strategic objective of thwarting Georgia's near-term NATO membership and laid down an unsettling marker that it was prepared to use military means to assert its "privileged" interests

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in its neighborhood. The failure of any neighboring country to endorse Russia's recognition of South Ossetia and Abkhazia reflects the regional unease over a revanchist Russia. Russia has focused its diplomatic efforts on "Old Europe" and encouraged French President Sarkozy's diplomacy, calculating that Europe's significant economic ties and energy interdependence will erode a policy of "no business as usual" in response to the invasion.

While Russia argues that Saakashvili "destroyed" Georgian territorial integrity, our goal is to keep the parties engaged in confidence building measures to improve security and provide for the return of refugees that, over the long-term, will allow Georgia to create the economic and political conditions to attract the breakaway regions back into its fold.

While Russia has participated in the Geneva talks, with the next session scheduled December 17-18, it has threatened to cut short the process and has done little to rein in its clients on the ground, where security remains poor in the areas adjoining both South Ossetia and Abkhazia, with EU monitors prevent from entering either territory.

#### The Foreign Policy Consensus

Your record of critically questioning missile defense will be seized upon here, where there is a consensus across the political spectrum that Russia was "humiliated" during its period of acute weakness in the 1990's and that important gestures by Putin, including acceding to the U.S. abrogation of the ABM treaty and post-9/11 assistance in staging the war in Afghanistan, went unreciprocated.

Many of your interlocutors will tell you that they see the U.S. as fundamentally intent on weakening Russia, including by "encircling" Russia in waves of NATO enlargement and by establishing U.S. basing and missile defense sites that over time could erode Russia's national security.

We see no difference in approach between Putin and Medvedev, especially over the basket of European security issues, including missile defense, NATO enlargement, CFE, and Kosovo.

Medvedev's "European Security Treaty," which received a chilly reception at the OSCE December Summit, is less a substantive initiative than a shot across the Euro-Atlantic bow that Russia is dissatisfied with the status quo. Specifically, you will hear the following arguments:

-- Missile Defense: Russia expects the new U.S. administration to revisit missile defense plans in Europe, and will argue that its offer of cooperation at the Qabala radar facility in Azerbaijan was a missed opportunity to present a common front against Iran. Russia's offer of cooperation was premised on the U.S. halting the development of radar and interceptor sites in the Czech Republic and Poland. Russia rejects the physics

driving the geographic selection of the two sites, and the U.S. decision to provide Poland with Patriot batteries has been pocketed

as evidence of the "anti-Russian" nature of the program. Since October 2007, we have proposed a number of transparency and confidence-building measures to reassure Russia, providing extensive technical briefings on the threat from Iran as well as on the characteristics of the system, showing that it could not be effective against Russia's nuclear arsenal. The latest round of talks will take place during your December 15 consultations

in Moscow, with no breakthrough expected. Moscow continues to insist that their experts be permanently stationed at the sites; something the two host countries cannot accept. Additionally, Moscow has balked at the idea of reciprocal access to Russian sites for the U.S., Poles and Czechs.

-- NATO: Russia welcomed NATO's decision to resume engagement in the NATO-Russia Council post-Georgia as a "return to realism," continuing its policy of demanding greater cooperation even as it decries the security organization as an existential threat to Russian security. While NATO reaffirmed the Bucharest Declaration's pledge that Ukraine and Georgia will become NATO members, your Russian interlocutors will argue strongly that further enlargement risks direct military confrontation. Ukraine remains Russia's brightest redline, with Russian officials positing that NATO membership and NATO bases in Ukraine means that Russia could lose a conventional war. Seventeen years after the collapse of the Soviet Union, we have yet to persuade the Russian body politic and populace that NATO is not a threat,

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with Baltic and Polish rhetoric reinforcing the impression here that NATO is still an alliance directed against Russia.

-- Conventional Forces in Europe Treaty: Russians point to the CFE as the archtypal outdated security structure, premised on the Cold War division of Russia versus the rest of Europe. Russia continues to maintain its December 2007 suspension of its Treaty obligations and to press for ratification of the Adapted Treaty by the NATO signatories, while insisting on changes to the Adapted Treaty, such as elimination of the flank regime for Russia. The U.S. continues to pursue a "parallel actions plan" that would culminate in ratification of the Adapted Treaty; however, Russia's recognition of Abkhazia and South Ossetia repudiate our operating premise that all Russian forces must leave all Georgian territory. Even prior to the Georgia conflict, Russia rejected linkage of the Adapted Treaty to political commitments to remove its forces from Georgia and Transnistria, and is playing on European concern over the absence of a viable CFE to push for western compromise.

-- European Security Treaty: The Russian argument is that the failure of existing European security architecture to prevent the conflict in Georgia confirmed the

need for a new European Security Treaty.

#### The Economic Crisis

The international financial crisis has replaced the war with Georgia as the defining issue for Russia's political class and public, with the "real economy" now taking a hit. The precipitous drop in oil, gas and other commodity prices, as well as the withdrawal of massive amounts of foreign investment,

exposed the weaknesses in the Russian economy. Prior to August 2008, the Russian economy had been growing fast, with real economic growth

of over 8% in 2007, a strong ruble, and record levels of foreign direct investment--\$41 billion in 2007 alone. Years of budget surpluses and rising oil prices had lifted the country's foreign currency reserves to almost \$600 billion, third highest in the world. August marked a clear turning point, when the stock market began to drop sharply, in response to hostilities with Georgia, slipping oil prices, and GOR statements intimating state interference in the economy. Money began to flow out of the country as investors sold their shares and Russians sold their rubles for dollars. By mid-September, the default by a pair of high-profile bank virtually froze lending activity, sending the stock market into meltdown.

The most optimistic expectations for 2009 are that the economy will grow by 3 percent, although some experts are predicting no growth or even negative growth should oil prices remain low. All told, the GOR has committed more than \$200 billion in short-term and long-term funds to supply liquidity, recapitalize banks, and support domestic securities markets. Nevertheless, tight credit markets at home and falling demand globally have forced a growing number of firms to cut production and staff. While Medvedev pledged with his G20 partners to eschew protectionist measures in response to the crisis, Putin clarified that Russia would take whatever steps necessary to protect its national interests.

Putin and Medvedev regularly attribute the Russian economic crisis to U.S. irresponsibility, and anti-Americanism could become a more prominent theme as the downturn intensifies in Russia.

#### The Politics of Energy Dependence

The energy sector remains central to the Russian economy, with the GOR failing to significantly diversify the Russian economy. Putin succeeded in reasserting state control over the energy sector, arguing that private and western interests had taken advantage of Russia in the 1990s. Today, the Russian government directly or indirectly controls the majority of production assets and directly controls the transportation networks. The move toward greater government control over the sector included the high-profile bankruptcy and liquidation of Yukos oil company and the forced sale to Gazprom of 51% of the Sakhalin 2 consortium. A newly passed strategic sectors law includes amendments that place many large oil and gas deposits largely off-limits to foreign investors. Currently, Russia produces just under 10 million barrels per day, second only to Saudi Arabia. Since 2005, however, production has tapered off and will decline in 2008 due to inefficient state control and an

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onerous tax regime. Russia is also by far the largest natural gas producer and has the world's largest gas reserves. State-controlled Gazprom dominates the sector, controlling 85% of production, all exports and the gas transportation network.

Gas production is stagnating as Gazprom has failed to adequately invest in new production areas.

As an "energy superpower," Russia banks on European energy

dependence to provide ballast to its relations with Europe, otherwise buffeted by criticism over Georgia and human rights. Russia supplies approximately one-half of European gas imports with some European countries completely dependent on Russia for their gas. Russia, for its part, is dependent on Europe for virtually all of its gas exports, which provide some three-quarters of Gazprom's revenues. Approximately 80% of Russian gas exports to Europe travel through Ukraine, which itself has a tense energy (and political) relationship with Russia. The Russian-European interdependence in the gas area is a key factor in their broader relationship as Europe seeks to diversify its gas supplies and Russia seeks to diversify its export routes and markets.

#### The Irritants: WTO and Jackson-Vanik

Russia is the last major world economy that is not yet a WTO member. Russia's years-long accession process neared the end game earlier this year but following the Georgian conflict once more looks to be delayed. Russia has completed bilateral market access talks with all interested WTO members, except for Georgia. In Russia's multilateral accession document, only a few key issues, such as agricultural supports, remain unresolved. Following the outbreak of hostilities with Georgia in August and with the realization that Russia would not be able to complete its entry process during 2008, senior GOR officials announced that Russia would reopen certain WTO commitments that it had agreed to implement in advance of accession.

Russia has reopened the U.S.-Russia Bilateral Agreement on Meat (poultry and pork), with negative consequences for U.S. exporters. U.S. and Russian trade and agriculture experts are now consulting on the issue.

While both President Medvedev and PM Putin have recently affirmed that Russia is still interested in WTO, the Russian government's actions in reopening previous agreements is a step in the wrong direction and is making early accession less likely. Anger over the protracted accession negotiations is matched by frustration over U.S. inaction in repealing Jackson-Vanik. While repeal of Jackson-Vanik would be essential for U.S. exporters to gain the full benefits of Russia's WTO accession when it occurs, Russians view the continuation of the Soviet-era amendment as a sign of U.S. lack of respect. (The fact that Russia and Israel have implemented visa-free travel adds insult to injury.)

#### The Bilateral Relationship

You will have an opportunity to ask your Russian interlocutors for their vision of U.S.-Russian relations under a new U.S. administration, and how best to manage a relationship that will be defined as much by cooperation as by competition. We share an important agenda, with on-going cooperation in safeguarding and reducing nuclear weapons stockpiles, preventing the emergence of a nuclear Iran, countering terrorism, advancing peace in the Middle East, pushing North Korea to wind down its nuclear program, and working collaboratively in space on projects that advance health and understanding of climate change.

Conclusion of a "123" agreement, set aside after the Georgia conflict, could open significant new cooperation and trade in civilian nuclear energy and build on our Global Nuclear Energy Partnership. We do not lack for a positive agenda, but will need to rebuild an architecture to our bilateral relationship that allows wide-ranging and candid engagement on all issues of concern.

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